

**Internal Revenue Service**  
**memorandum**

CC:TL:Br2  
SJHankin

date: MAR 26 1986

to: District Counsel, Honolulu W:HON

from: Director, Tax Litigation Division CC:TL

subject:

Tax Periods: [REDACTED], [REDACTED], [REDACTED]  
(Pre - 90 day case)

This is in response to your memorandum, dated March 2, 1984, requesting technical advice on the following issue.

ISSUE

Whether losses resulting from the partial worthlessness of a note received by the taxpayers from the sale of certain corporate stock and convertible notes to an unrelated third party are properly characterized as ordinary business bad debt deductions under I.R.C. § 166 or as capital losses under the Arrowsmith doctrine, I.R.C. § 453(d) or I.R.C. § 1232(a)

CONCLUSION

We conclude that the taxpayers are entitled to business bad debt deductions under section 166(a) as a result of the partial worthlessness in [REDACTED] and [REDACTED] of the note originally received by the taxpayers from the sale of corporate stock and convertible notes to an unrelated third party ([REDACTED]). That conclusion, in turn, is based on the following:

(1) No "satisfaction" or "disposition" of an installment obligation within the meaning of Code section 453(d)(1) (applicable to dispositions made before October 20, 1980), occurred in this situation, because the taxpayers' legal rights on the installment note neither disappeared nor were materially altered. As such, section 453(d) will not cause the worthlessness loss to be treated as a capital loss.

(2) Even if the installment note at issue falls within the coverage of section 1232(a) as constituting an evidence of indebtedness, there was no "retirement" of the note within the meaning of section 1232, that would generate capital loss treatment under that Code section.

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(3) The Arrowsmith doctrine (The look-back principle) does not apply to this situation, because the worthlessness of the note stemmed from subsequent events and conditions that ~~were~~ not related to the events and conditions existing at the time the stock was sold and the note issued. Accordingly, the tax character of the worthlessness loss should not be determined by looking back to the original transaction in which the note was acquired.

FACTS AND DISCUSSION

We incorporate, herein by reference, the memorandum, dated June 28, 1985, sent to this office and prepared by the Interpretative Division in connection with this case, (CC:I-141-84).

Sincerely,

ROBERT P. RUWE  
Director

By: Alfred C. Bishop, Jr. /c.m.H  
ALFRED C. BISHOP, JR.  
Chief, Branch No. 2  
Tax Litigation Division

Attachment:

O.M., dated June 28, 1985